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SUBITO FINITO!

We have a Swiss friend who loves to use this Italian phrase. Literally it means immediately finished, but the meaning of these two words is instinctively understood even without translation.

The Dow Jones Industrial Averages were up about 225 points on June 2, 2010. Great. But it was down 112 points the day before. Today June 4 at 11:30 AM the Dow 30 Industrials were down 232. The major market indices have had 1%, 2% or 3% or more swings one way or the other in the majority of trading days over the last month or so. So far 2010 has been a most volatile year.

May was the worst month for the Dow Jones industrial Average since May of 1940. And hedge funds are reported to have taken one of the worst drubbings ever for one month in May.

We are pointing this out with the objective of shedding just a little light on the subject of market volatility and what causes it.

It used to be that when the markets had an unusually strong or weak day, we would ask "what happened?" And there usually would be a somewhat logical answer. If an important event or events would come to the attention of investors, they would be prompted to assess the situation and buy or sell securities based on that assessment.

In those bygone days there were the New York Stock Exchange, the American Stock Exchange and the over-the-counter dealer markets - now Nasdaq. The NYSE was the major of the two Stock Exchanges in this country. Now instead of being one of two stock exchanges it is one of about 50 stock exchanges because of the explosion of new stock exchanges, particularly in the last decade.

Until May Day (May 1, 1975) investors bought and sold stock through their brokers at a fixed, not negotiated, commission rate.

"Listed" orders (meaning stocks listed on the New York or American Stock Exchange) would be given by the investor to his broker who would then send it to the Exchange Floor where the stock was listed to be executed at a set limit or "at the market" with the assistance of floor brokers (two dollar brokers) who then would go to various specialists to execute the order. All stocks had a specialist whose responsibility it was to maintain orderly markets - i.e. minimize volatility - in the stocks for which they acted as specialists.

Stocks not listed on an exchange were bought and sold at negotiated prices by various dealers in the over-the-counter markets, now Nasdaq.

It was mainly a very personal system, a very logical system, and it worked very, very well the vast majority of the time for many, many years.

"Mother Merrill" (Merrill Lynch) was even referred to as "The Thundering Herd."

And when I was with Lehman Brothers in those olden days, the partnership reportedly spent more than \$1 million a year to keep their name out of the press. The last thing Lehman Brothers or Goldman Sachs wanted was publicity. They remembered negative publicity they received during the markets of the Depression. Now all is forgotten.

The brokerage firms at that time were partnerships not corporations. Money was made or lost by the partners who, as the owners of the firm, took great pride and responsibility in the reputation of their firm.

The money made today in Wall Street is paid in the form of bonuses to employees, not to the stockholder-owners as was the case with the partnerships.

FAST FORWARD

Today it is estimated that upwards of 70% of stocks traded are being traded every day between computers. That of course is not an exact figure, but it does provide an estimate of how many stocks are being traded by customized computer software and black boxes --- not by

human hands or, more importantly, by human minds. Approximately 30% of trading is then divided among individual investors, institutions, hedge funds, mutual funds and so on.

This system does not always work well and is the root cause of a great deal of the extreme volatility in today's markets. It has nothing to do with our concept of investing. It may be good for Goldman Sachs and its ilk, the large hedge funds and others in that game. (Goldman Sachs reported in a filing with the Securities and Exchange Commission on March 1, 2010 that it had made at least \$100 million in net trading revenues on 131 days last year - equivalent to once every other trading day.)

An example of what computer trading can do for you: On Thursday, May 6, 2010, shortly after 2:30 PM, the Dow Jones Industrial Average began to wobble and lost 998.5 points including a 500 point fall in a matter of seconds. It finally closed down 347.8 points for a mere 3.2% decline on the day. On the next day, Friday, the Dow Jones managed to swing through a 350 point range to close down 115.49 points or 1.1%.

The Global Edition of the *New York Times* reported on Saturday/Sunday, May 8/9 2010 concerning Thursday's, May 6th's, Flash Crash: "Federal agencies began inquiries after more than \$700 billion in value was erased in an eight-minute span. 'The regulatory authorities are evaluating this closely,' U. S. President Barack Obama said at the White House." Today, June 4, 2010, there are still no satisfactory answers as to what caused the May 6 Flash Crash. Do you think a similar crash could happen again? **Subito finito!**

It was reported in that same article: "Increases in automation and competition have reduced the NYSE and Nasdaq's volume in securities they list from as much as 80% in the past decade. Now, less than 30% of trading in their companies takes place on their networks as orders are dispersed to as many as 50 competing venues, almost all of them fully electronic. Twenty years ago, fewer than 10 exchanges competed for all U.S. equity trades."

We have been waiting, without success, for some clarity for the public's benefit concerning what is known as "High-frequency trading." This is an operation where trading firms with supercomputers buy data from stock exchanges. They use that data to purchase millions or hundreds of millions of dollars worth of stocks and then sell them, often instantaneously, without the transactions being disclosed.

"While legal, the practice pushes the envelope of what is fair, critics say, and raises questions about the advantages some fast-moving traders are gaining in the market."

Today's computer trading programs have, in our opinion, very little connection with reality and virtually none with the well-being of the individual investor. And we haven't even mentioned the "Dark Pools" where massive trading takes place away from all exchanges.

The individual investor's instincts correctly tell him that, at the very least, the markets are not a level playing field - most certainly not tilted in his favor.

We suspect the only reason for these activities' being legal is that laws making them illegal have not yet been written. This is where money and politics are inextricably tied to today's markets. In order to have these practices continue to be legal, it requires a great deal of money, much of which finds itself ending up in the pockets of the politicians.

We quote from the June 4, 2010 issue of the *Wall Street Journal*.

"Critics call the practice the modern-day equivalent of looking at share prices listed in tomorrow's newspaper stock tables today. 'It is a rigged game,' Sal Arnuk, cofounder of brokerage firm Themis Trading, said Wednesday at a Securities and Exchange Commission roundtable discussion in Washington, referring to the trading activity, which some call 'latency arbitrage.'

The people involved in the securities dominating electronic trading business are definitely not looking out for you. But why would anyone think they would be?

We don't ask "what happened?" anymore. There is almost never a plausible answer.

SUBITO FINITO! and Good Luck!

John W. Hamilton

June 4, 2010

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SINCE 1980 - 30 YEARS